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**Paper for the House Committee meeting on 16 December 2016**

**Report of the Subcommittee on Inland Revenue Ordinance  
(Amendment of Schedule 17E) Notice 2016**

**Purpose**

This paper reports on the deliberations of the Subcommittee on Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016 ("the Subcommittee").

**Background**

Hong Kong's policy approach to automatic exchange of financial account information in tax matters

2. For the purpose of enhancing tax transparency and combating cross-border tax evasion, the Organisation for Economic Co-operation and Development ("OECD") released in July 2014 the new "Standard for Automatic Exchange of Financial Account Information in Tax Matters" ("AEOI Standard").<sup>1</sup> In brief terms, the AEOI Standard requires a financial institution ("FI")<sup>2</sup> to conduct due diligence procedures to identify reportable accounts held by tax residents of reportable jurisdictions (i.e. tax residents who are liable to tax by reason of residence in the AEOI partner jurisdictions), and collect the required information in respect of these reportable accounts. FIs are also

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<sup>1</sup> The AEOI Standard comprises: (a) Model Competent Authority Agreement ("Model CAA"); (b) Common Reporting Standard ("CRS"); (c) Commentaries on the Model CAA and CRS; and (d) Guidance on Technical Solutions.

<sup>2</sup> Under section 50A of the Inland Revenue Ordinance (Cap. 112), "financial institution" means (a) a custodial institution; (b) a depository institution; (c) an investment entity; or (d) a specified insurance company. For the purpose of implementing AEOI in Hong Kong, only FIs which are resident in Hong Kong will be subject to the reporting requirement.

required to report such information to the tax authority in a specified format. Upon receipt of the information from FIs, the tax authority will exchange the relevant information with their counterparts in the reportable jurisdictions concerned on an annual basis.

3. In order to catch up with the latest international standard for AEOI, Hong Kong indicated to the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") of OECD in September 2014 its support for implementing AEOI on a reciprocal basis with appropriate partners,<sup>3</sup> with a view to commencing the first information exchange by end of 2018 (i.e. the latest timeline permissible by the Global Forum).

4. In this regard, the Administration intends to conduct AEOI only with those jurisdictions with which Hong Kong has signed comprehensive avoidance of double taxation agreements ("CDTAs") or tax information exchange agreements ("TIEAs") on a bilateral basis under the exchange of information ("EOI") mechanism (i.e. Hong Kong's CDTA/TIEA partners).<sup>4</sup> Under this approach, Hong Kong will make use of the bilateral CDTAs or TIEAs signed as the basis for implementing AEOI. To enable the implementation of AEOI, the Inland Revenue Department ("IRD") will have to sign a new Competent Authority Agreement ("CAA"), which sets out the modalities of transfer of information collected pursuant to the AEOI Standard, with the competent authority of the CDTA/TIEA partner concerned.

#### Inland Revenue (Amendment) (No. 3) Ordinance 2016

5. Against the above background, the Administration enacted the Inland Revenue (Amendment) (No. 3) Ordinance 2016 ("the Amendment Ordinance")<sup>5</sup> to provide for the legal framework for implementing AEOI in Hong Kong. The Amendment Ordinance, which came into effect on 30 June 2016, amended the Inland Revenue Ordinance (Cap. 112) ("IRO") to incorporate the essential requirements of the AEOI Standard.

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<sup>3</sup> The Global Forum has 137 members (as at November 2016). It is an international body for ensuring the implementation of the internationally agreed standards of transparency and exchange of information in the tax area.

<sup>4</sup> CDTAs are tax agreements which seek to minimize incidence of double taxation between the contracting parties and provide a mechanism for EOI between tax authorities, whereas TIEAs serve as EOI instruments without offering any taxation relief. As at November 2016, Hong Kong has signed CDTAs with 35 jurisdictions and TIEAs with seven jurisdictions.

<sup>5</sup> The Inland Revenue (Amendment) Bill 2016 was introduced into the Legislative Council in January 2016, and was passed on 22 June 2016. A Bills Committee was formed to examine the Bill.

6. The Amendment Ordinance has added a new section 50J to IRO which empowers the Secretary for Financial Services and the Treasury to amend, among others, Schedule 17E to IRO ("Schedule 17E") by notice in the Gazette to provide for a list of reportable jurisdictions and a list of participating jurisdictions. Such amendments are subject to negative vetting by the Legislative Council ("LegCo").

### **The Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016**

7. On 28 October 2016, the Administration published in the Gazette the Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016 ("the Notice") which seeks to amend Schedule 17E by including:

(a) in Part 1 of Schedule 17E, Japan and the United Kingdom of Great Britain and Northern Ireland ("UK") as "reportable jurisdictions", with 2018 as the corresponding "reporting year";<sup>6</sup> and

(b) in Part 2 of Schedule 17E, all jurisdictions committed to adopting AEOI by 2018 (i.e. 100 jurisdictions excluding Hong Kong) as "participating jurisdictions".

8. The Notice was tabled before LegCo at its meeting of 2 November 2016 and is subject to the negative vetting procedure. It will come into operation on 31 December 2016.

### **The Subcommittee**

9. At the House Committee meeting held on 4 November 2016, Members agreed to form a subcommittee to study the Notice. The membership list of the Subcommittee is in the **Appendix**. Under the chairmanship of Hon Kenneth LEUNG, the Subcommittee held one meeting with the Administration on 15 November 2016 to examine the Notice.

10. To allow sufficient time for the Subcommittee to prepare a report on its deliberations for submission to the House Committee, the Subcommittee Chairman moved a motion at the Council meeting of 23 November 2016 to extend the scrutiny period to the Council meeting of 11 January 2017. The motion was passed.

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<sup>6</sup> "Reporting year" refers to the year that IRD has to start exchanging reportable information with the reportable jurisdictions concerned.

## **Deliberations of the Subcommittee**

11. The Subcommittee supports the inclusion of the jurisdictions as specified in the Notice to the lists of reportable jurisdictions and participating jurisdictions respectively for the implementation of AEOI in Hong Kong. In the course of deliberations, the Subcommittee has examined the approach for inclusion of reportable jurisdictions and the operational arrangements for automatic exchange of information with such jurisdictions, the "look-through" requirement in the AEOI Standard, and issues related to the list of participating jurisdictions and other related matters. The deliberations are summarized in the ensuing paragraphs.

### Approach for the inclusion of reportable jurisdictions

12. The Subcommittee notes that Hong Kong has adopted the approach to conduct AEOI only with its CDTA/TIEA partners (i.e. 42 such jurisdictions in total), by separately signing CAAs with them on a bilateral basis. After signing the CAAs, the Administration will include the relevant jurisdictions as reportable jurisdictions under Part 1 of Schedule 17E. Members have queried why only Japan and UK are included as reportable jurisdictions so far, and asked about the Administration's plan to include other jurisdictions, in particular those that are actively pushing forward AEOI.

13. The Administration has explained that following the passage of the Amendment Ordinance in June 2016, IRD has liaised with 10 jurisdictions from July to September 2016, and among them Japan and UK have signed CAAs with Hong Kong so far. The current progress is in line with the Administration's plan to adopt a pragmatic and progressive approach to meet the requirement of commencing the first automatic exchanges by 2018, whilst minimizing the compliance burden on FIs and their non-Hong Kong tax resident account holders. Going forward, the Administration will seek to expand Hong Kong's network of AEOI and commence CAA discussions with other CDTA/TIEA partners.

### Operational arrangements for automatic exchange of information with reportable jurisdictions

14. The Subcommittee notes that upon inclusion of Japan and UK as reportable jurisdictions in Part 1 of Schedule 17E with 2018 as the reporting year, (a) FIs shall start conducting due diligence procedures in respect of their financial accounts in 2017; (b) IRD will issue notices to all FIs maintaining reportable accounts in January 2018 (and January annually thereafter); (c) FIs should lodge the AEOI returns within five months after the calendar year to which the information relates; and (d) IRD will then commence the first information exchange with the tax authorities of Japan and UK in

September 2018 (and September annually thereafter). Given the bulk of information involved and that the volume will increase when Hong Kong progressively expands its list of reportable jurisdictions in future, members have asked about the feasibility of spreading out the deadlines for FIs to submit the AEOI returns in respect of different jurisdictions over different months of a reporting year.

15. According to the Administration, the automatic exchange of information among tax authorities in September each year is a common timeframe for all reportable jurisdictions. To meet this timeframe, FIs will be required to submit their AEOI returns to IRD by May in the reporting year concerned. The Administration has further advised that OECD will put in place a Common Transmission System for exchange of information among tax authorities. At the domestic level, IRD will put in place a secure platform, i.e. the AEOI Portal, for FIs to submit notifications and file returns on required information of reportable accounts electronically. The Administration envisages that with this new electronic platform in place, the processing and exchange of data will not create too much administrative burden on IRD.

16. At the Chairman's request, the Administration has provided supplementary information regarding the development of the AEOI Portal. According to the information provided, the AEOI Portal will form part of the Government's system infrastructure for delivering electronic services. IRD has redeployed existing staff and recruited contract programmers with the relevant expertise to form an in-house team to carry out the system development and implementation work. In procuring the necessary hardware and software for the AEOI Portal, IRD has been following the Government's established procurement procedures. IRD plans to conduct a thorough testing and trial run, with participation of selected FIs in mid-2017 before launching the AEOI Portal.

17. In respect of the handling of data to be exchanged under AEOI and in particular the safeguarding of data confidentiality, the British Consulate-General in Hong Kong wrote to the Subcommittee on 7 December 2016 providing information about the relevant measures that the HM Revenue and Customs of UK has already put in place.<sup>7</sup>

#### "Look through" requirement in the Standard for Automatic Exchange of Financial Account Information in Tax Matters

18. The Subcommittee notes that under the AEOI regime, FIs are put under a positive obligation to perform due diligence procedures to identify financial

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<sup>7</sup> The letter from the British Consulate-General in Hong Kong was circulated to members of the Subcommittee vide LC Paper No. CB(1)284/16-17(01) on 9 December 2016.

accounts held by tax residents of reportable jurisdictions in 2017 and furnish the reportable information to IRD starting from the reporting year (i.e. 2018 in the cases of Japan and UK). Members have asked about the corresponding legal implications and obligations of FIs associated with the listing of participating jurisdictions under Part 2 of Schedule 17E.

19. The Administration has explained that there is a "look through" requirement in the AEOI Standard under which FIs should "look through" an account holder which is a professionally managed investment entity, with its income primarily attributable to investing, reinvesting, or trading in financial assets ("relevant entity"), if the relevant entity is resident in a non-participating jurisdiction (i.e. a jurisdiction not on the list of participating jurisdictions). In such case, FIs will be required to see if any of the controlling persons of the relevant entity is a tax resident of a reportable jurisdiction. If affirmative, the FI concerned will be required to report such information to IRD for exchange with the reportable jurisdictions concerned. This "look through" requirement seeks to prevent controlling persons from "hiding" their identity behind the relevant entities residing in a non-participating jurisdiction. As the "look through" requirement will not apply if the relevant entity is resident in a participating jurisdiction, the extent to which FIs will be required to conduct "look through" checks depends on the list of participating jurisdictions. Having regard to OECD's requirements and the aim of reducing the compliance burden of FIs, the Administration has included all the 100 jurisdictions committed to adopting AEOI (excluding Hong Kong) as participating jurisdictions under Part 2 of Schedule 17E.<sup>8</sup>

20. The Subcommittee has also sought clarification on the impact of the above "look through" requirement on Hong Kong's taxpayers. The Administration has explained that, while "look through" checks by FIs of Hong Kong are not targeted at Hong Kong tax resident account holders, the same "look through" checks will be conducted by Hong Kong's AEOI partners (i.e. Japan and UK, and other reportable jurisdictions subsequently included). Under such requirement, FIs of these reportable jurisdictions will "look

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<sup>8</sup> In setting out the list of participating jurisdictions, OECD allows for the following options:

- (a) jurisdictions having in place a CAA for AEOI;
- (b) all jurisdictions committed to adopting AEOI by 2018 (i.e. 100 jurisdictions excluding Hong Kong); or
- (c) jurisdictions having signed the Multilateral CAA (i.e. 87 jurisdictions as at November 2016).

Hong Kong has adopted option (b) above in setting out the list of participating jurisdictions.

through" a relevant entity that is resident in a non-participating jurisdiction and furnish relevant information of the controlling persons who are Hong Kong tax residents to their respective tax authorities for exchange with IRD.

21. The Administration has also advised that for the purpose of identifying reportable accounts, FIs will be required to obtain self-certifications from new account holders to ascertain their tax residences and obtain information on their taxpayer identification numbers. As regards pre-existing account holders, FIs may determine their tax residences by reviewing the available information they have maintained, and if the FIs have doubt on the tax residence of a pre-existing account holder, the FIs may also obtain a self-certification from the account holder concerned.

#### Issues relating to the list of participating jurisdictions

22. The Subcommittee has asked whether the list of participating jurisdictions in Part 2 of Schedule 17E will have to be constantly updated if more jurisdictions commit to adopting AEOI, and the updating mechanism thereof.

23. The Administration has advised that in principle, Hong Kong will include all additional jurisdictions committed to adopting AEOI as participating jurisdictions in Part 2 of Schedule 17E. Frequent additions are however unlikely, and can be dealt with in batches when updating the list of reportable jurisdictions in Part 1 of Schedule 17E.

24. The Subcommittee notes that some jurisdictions including the United States ("US") and certain Southeast Asian countries such as Thailand are not committed to adopting AEOI and thus are not included as participating jurisdictions in Part 2 of Schedule 17E pursuant to the Notice. They have enquired whether and how the non-participation of such jurisdictions will affect the implementation of AEOI in Hong Kong.

25. According to the Administration, most of the major economies in the world and economies with necessary capacity to implement the AEOI Standard have already been committed to adopting AEOI by 2018. As regards the US, the Administration has advised that the US has not signed up to implement AEOI because its Financial Account Tax Compliance Act has served a similar purpose to require foreign FIs (including those in Hong Kong) to report financial account information in respect of their US clients to the US Internal Revenue Service directly. Other jurisdictions which have yet to be committed to AEOI may undertake to adopt AEOI in due course.

26. Noting that some "tax havens" like British Virgin Islands and Cayman Islands are on the list of participating jurisdictions, the Subcommittee has

sought clarification on the Government's policy towards exchange of information in tax matters with such jurisdictions, and whether the Administration will initiate negotiations or explore the opportunity for bilateral agreements with these jurisdictions to enable IRD to obtain more comprehensive financial information on Hong Kong's taxpayers from these jurisdictions.

27. In response, the Administration has indicated that IRD will consider whether it will be in the best interest of Hong Kong to adopt CDTA or TIEA when pursuing exchange of tax information with other jurisdictions. TIEAs provide an alternative route to CDTAs for jurisdictions to pursue exchange of tax information between them without providing any taxation relief. For the time being, the Administration needs to focus its efforts in concluding more CAAs with Hong Kong's existing CDTA/TIEA partners.

### **Recommendation**

28. The Subcommittee raises no objection to the Notice. Both the Subcommittee and the Administration will not propose any amendment to the Notice.

### **Advice sought**

29. Members are invited to note the deliberations of the Subcommittee.

Council Business Division 1  
Legislative Council Secretariat  
14 December 2016

**Subcommittee on Inland Revenue Ordinance  
(Amendment of Schedule 17E) Notice 2016**

**Membership list**

**Chairman**            Hon Kenneth LEUNG

**Members**            Hon James TO Kun-sun  
                             Hon WONG Ting-kwong, SBS, JP  
                             Hon WU Chi-wai, MH  
                             Hon Christopher CHEUNG Wah-fung, SBS, JP  
                             Dr Hon YIU Chung-yim

(Total : 6 members)

**Clerk**                Ms Doris LO

**Legal Adviser**    Ms Clara TAM